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September 13, 2005

Jeffrey E. Kupfer
President's Advisory Panel on Federal
Tax Reform
1440 New York Avenue, N.W.
Washington, DC 20005
United States of America

Dear Jeff:

Attached is information on the results of two surveys regarding the views of business on various tax changes and tax reform options that have been discussed by the President's Advisory Panel on Federal Tax Reform. We thought the information might be useful to the Advisory Panel as it evaluates alternatives.

If you have any questions or would like to discuss, please feel free to call Phil Moseley of Washington Council Ernst & Young at (202) 327-6319 or me at the number above.

Very truly yours,



Pamela F. Olson

Attachments

Ranking of Tax Reform Options by Large U.S. Multinational Corporations

The Tax Council Policy Institute's February 2005 Symposium on the U.S. International Tax Regime included a survey of large multinational corporations' views on tax obstacles to business competitiveness. Results from 25 Fortune 100 companies representing a wide range of industries were presented.

As a follow-up to the TCPI survey, Ernst & Young conducted a second survey in August 2005 which included many of the same respondents to the TCPI survey and some additional ones. The survey was designed to provide some additional insights about the views of the multinational corporate community to alternative tax reform proposals.

Business support for any particular reform proposals will depend on the overall package of reforms. In particular, business taxpayers are concerned about whether potential tax reform proposals will be revenue neutral or whether they will result in a shift in the overall tax burden to the business community. Reform proposals that increase the tax burden borne by the business community are likely to be unfavorably received.

Lowering the current 35% U.S. corporate income tax rate is the most preferred option to a majority of, but not all, U.S. based multinational corporations responding to the survey. Liberalizing the U.S. tax treatment of foreign-source active income is the second most preferred option, consistent with the earlier TCPI survey. The other findings demonstrate that most of the U.S. multinational corporations responding to the survey favor familiar, tested, and simpler tax approaches to fundamental tax reform, consumption taxes and corporate integration.

Tax Reform Options

- Reducing the corporate marginal tax rate was the most preferred choice of 59% of the respondents. 88% of the respondents ranked it as one of their first three choices, while 6% would oppose such a proposal.
- The next most popular tax reform option is liberalizing the treatment of foreign-source active income. 24% of the respondents ranked it as their first choice; 76% among their first three choices.
- Expensing of physical capital assets affects companies very differently and is a favored option of 47% of the companies responding.
- No other tax reform options garnered strong support, while several tax options, including replacing the income tax with a consumption tax and conforming book and taxable income, were ranked by more than half of the respondents as their least two favored.

Consumption Tax Options

- As indicated in Table 1, most companies ranked replacing the U.S. income tax with a consumption tax as their least preferred tax reform option, but when comparing alternative replacement consumption taxes, 75% of the companies preferred a value-added tax to other types of consumption taxes (Table 3).
- A majority of the respondents (61%) strongly disliked the idea of a value added tax in addition to the current income taxes. (Table 2)

Eliminating Double Taxation of Corporate Income Options

- While not an important overall tax reform priority to the companies, if consideration is given to eliminating double taxation, the vast majority (87%) of the responding companies prefer eliminating double taxed corporate income with a corporate dividends paid deduction or a shareholder dividend exclusion. (Table 4)

Eliminating Deferral and Reducing Corporate Tax Rates

- Over half of the companies oppose eliminating deferral, irrespective of the level of the reduction of the corporate tax rate. (Table 5)

Survey Results

Table 1
Ranking of Tax Reform Options

Tax Reform Options	Average Rank	% Ranked 1st	% Ranked in Top 3	% Ranked Two Lowest
Reduce the corporate income tax rate	1.9	59%	88%	6%
Liberalize treatment of foreign-source active income	2.6	24%	76%	6%
Eliminate double taxation of corporate income	3.5	0%	53%	6%
Provide for expensing of capital investment	3.7	12%	47%	18%
Implement a territorial tax system (JCT description)	5.0	6%	18%	47%
Conform book and tax income	5.6	0%	18%	65%
Replace US income tax with a consumption tax	5.8	0%	0%	53%

Table 2
Ranking of Adding a Value-Added Tax on Top of the Current Income Tax System

Ranking	% Respondents
Most preferred (Rank 1)	23%
Rank 2	8%
Rank 3	8%
Rank 4	0%
Rank 5	15%
Least preferred (Rank 6)	46%

Table 3
Ranking Replacement of Current Income Tax with a Consumption Tax, If a Consumption Tax Was Going to be Enacted 1/

Replacement Options	Average Rank	% Ranked 1st	% Ranked Two Lowest
Replace individual and corporate income taxes with a VAT	2.5	25%	8%
Replace corporate income tax with a VAT	2.9	50%	33%
Replace individual and corporate income taxes with Flat Tax and/or CBIT w/ expensing	3.1	25%	33%
Replace individual and corporate income taxes with a national retail sales tax	3.8	0%	50%
Replace individual and corporate income taxes with progressive consumption tax (X Tax)	4.3	0%	75%

1/Replacing the U.S. income tax with a consumption tax was the least preferred choice among general tax reform options. See Table 1.

Table 4
Ranking Options to Eliminate the Double Tax on Corporate Income

Options for Eliminating the Double Tax	Average Rank	% Ranked 1st	% Ranked Two Lowest
Shareholder exclusion for corporate dividends	1.8	31%	6%
Corporate deduction for dividends paid	1.9	56%	13%
Shareholder credit for corporate taxes paid	3.1	6%	25%
CBIT (interest and dividends neither deductible by corporations nor taxable to investors)	4.0	0%	81%
Expand opportunities for flow through corporate income to shareholders	4.3	6%	75%

Table 5
Rate at Which Support Eliminating Deferral

Oppose Regardless of Rate	30%	25%	20%	15%
53%	18%	12%	0%	18%

The Survey

Tax Reform Options. Which of the following reforms would you favor?

Rank your choices from most favored (1) to least favored (7). If you would **oppose** a particular proposal, please put the number ranking for that proposal in brackets: e.g. [7]. Assume that all proposals would be designed to be revenue neutral (e.g., via an offsetting tax rate or base change).

- _____ Replace, in whole or in part, the U.S. income tax with a consumption tax.
(See "Consumption Tax" below to specify your preferred type of consumption tax.)
- _____ Reduce the corporate marginal tax rate
- _____ Provide for the expensing of capital investment
- _____ Conform book and tax income, such that book income, with various modifications, becomes the tax base
- _____ Eliminate double taxation of corporate income. (See "Eliminating the Double Tax" below to specify your preferred method of integration.)
- _____ Liberalize treatment of foreign-source active income (e.g., repeal of CFC rules on foreign base company sales and services income, look-thru treatment of payments between related CFCs under foreign personal holding company income rules, treat members states of the European Union as one country for subpart F purposes, etc.)
- _____ Implement a territorial tax system

Eliminating Deferral and Reducing Corporate Rates. How low would corporate marginal rates have to fall for you to support eliminating deferral of taxation of income earned by foreign operations conducted by foreign corporate subsidiaries?

- _____ 30%
- _____ 25%
- _____ 20%
- _____ 15%
- _____ Oppose regardless of rate.

Value Added Tax. If a VAT were to be imposed, would you prefer?

- _____ credit-invoice VAT
- _____ subtraction method VAT
- _____ no preference

Consumption Tax. Which of the following ways of enacting a consumption tax do you favor? Rank your choices from most favored (1) to least favored (6). If you would oppose a particular proposal, please put the number ranking for that proposal in brackets: e.g. [6]. Assume that all proposals would be designed to be revenue neutral (e.g., via an offsetting tax rate or base change).

- _____ Add a value added tax (VAT) on top of an income tax system
- _____ Replace U.S. corporate income tax with a VAT

- _____ Replace U.S. individual and corporate income taxes with a VAT
- _____ Replace U.S. individual and corporate income taxes with a national retail sales tax
- _____ Replace U.S. individual and corporate income taxes with a Flat Tax and/or CBIT with expensing
- _____ Replace U.S. individual and corporate income taxes with progressive consumption tax (e.g., X Tax).

Eliminating the Double Tax on Corporate Income. Which of the following methods of integrating the corporate and individual tax systems would you favor? Rank your choices from most favored (1) to least favored (5). If you would oppose a particular proposal, please put the number ranking for that proposal in brackets: e.g. [5]. Assume that all proposals would be designed to be revenue neutral (e.g., via an offsetting tax rate or base change)

- _____ Shareholder exclusion for corporate dividends
- _____ Shareholder credit for corporate taxes paid
- _____ Corporate deduction for dividends paid
- _____ CBIT (interest and dividends neither deductible by corporations nor taxable to investors)
- _____ Expand opportunities to flow through corporate income to shareholders (e.g., repeal the restriction on MLPs and expand eligibility for S Corp treatment)

Additional Comments. Please include any additional comments on tax reform options, including reforms you might prefer to any of those listed above: